Transnational Corporations, Extractive Industries and Development

UNCTAD

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Overview

Foreign direct investment (FDI) represents the largest share of external capital flows to developing countries. Through their investments, transnational corporations (TNCs) can bring new technology, management know-how and improved market access to a host country. FDI can therefore be an important force for development. At the same time, benefits cannot be taken for granted. To secure development gains from FDI, it is essential that countries establish adequate institutions and policies, and build domestic productive capabilities. This is particularly important in the case of the extractive industries.

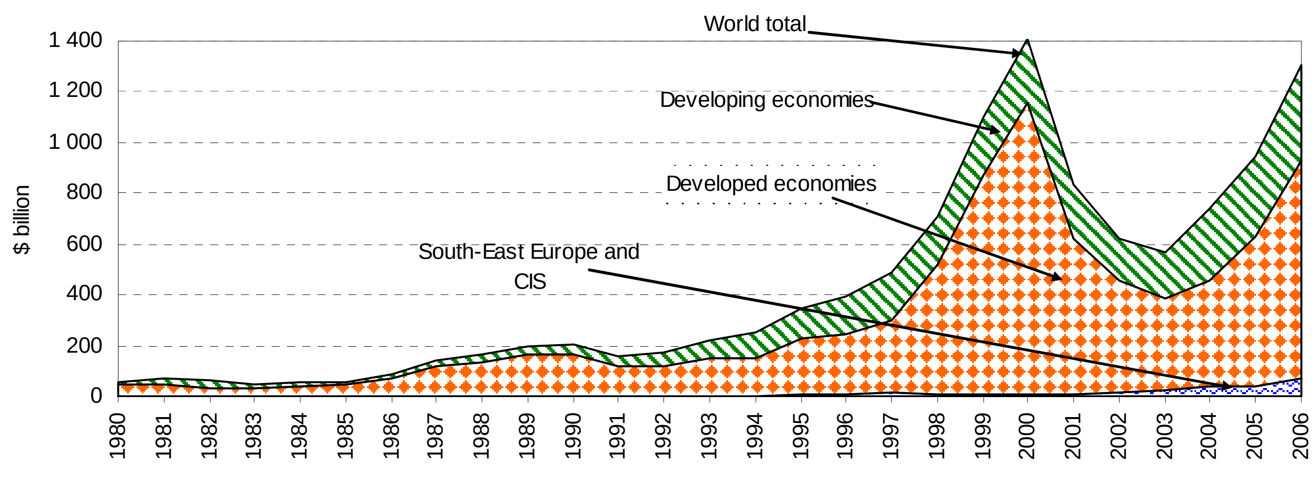
Record FDI flows to developing countries in 2006

Reflecting strong growth in the global economy and high corporate profits, world FDI inflows grew by 38% in 2006 to reach $1.3 trillion (see Figure 1). Investments increased in virtually all parts of the world. Among the developing regions, Asia was the top recipient. With record inflows of almost $260 billion, it received more than two thirds of all FDI to developing countries. The second largest destination was Latin America and the Caribbean, with $84 billion. Africa saw its highest inflows ever: $36 billion, or twice as much as in 2004. Despite this increase, Africa's share in global FDI fell to 2.7% in 2006, compared with 3.1% in 2005. FDI to South-East Europe and the Commonwealth of Independent States increased to a new record level: $69 billion.

The United States was the top recipient in 2006, followed by the United Kingdom. China again ranked first among developing countries, and the Russian Federation attracted the largest inflows of the transition economies. While most FDI originated in the developed world, outflows from developing and transition economies rose to a record high, underscoring the growing clout of TNCs from emerging economies. In fact, for the first time, as many as seven companies from developing countries are among the world's top 100 TNCs. This trend is important, as a large part of these outflows go to other developing countries, resulting in closer South-South economic ties.

As in previous years, cross-border mergers and acquisitions were responsible for large parts of global FDI. This was particularly the case in developed countries. In North America, cross-border M&As almost doubled. In Europe, the United Kingdom was the main target country, while Spanish companies were very active as ac-

Figure 1. FDI inflows, global and by group of economies, 1980-2006 (Billions of Dollars)



Source: UNCTAD, FDI/TNC database

quirers. Companies from developing and transition economies have also been increasingly engaged in such transactions, the largest in 2006 being the $17 billion acquisition of Inco (Canada) by CVRD (Brazil). As many as 172 mega deals (i.e. deals worth over $1 billion) were recorded in 2006.

Global FDI figures are expected be even higher in 2007. UNCTAD surveys suggest that investment activity may continue to grow in the next two years. But such forecasts are inherently uncertain, and future FDI prospects will depend largely on how well risks and uncertainties — such as financial instability and high energy prices — in the global economy are addressed.

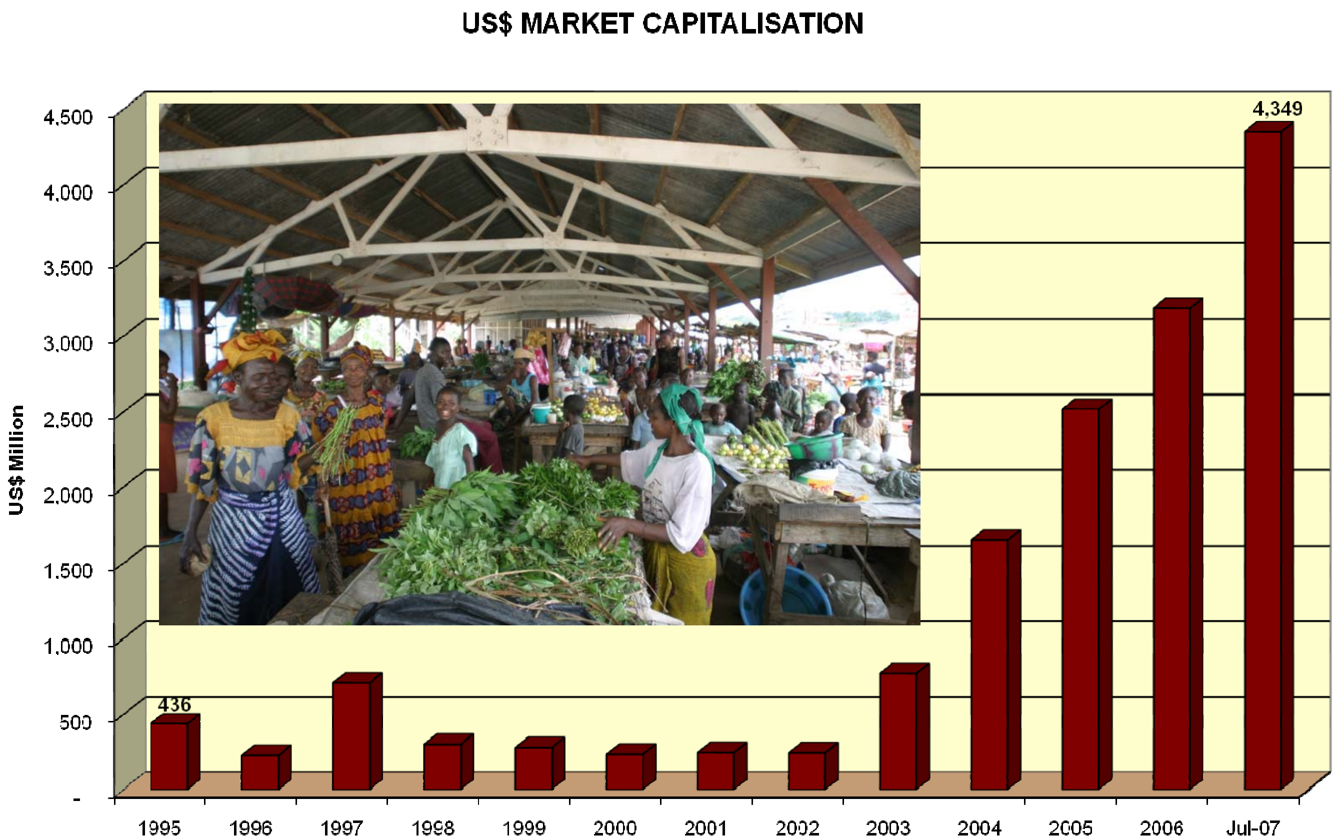
The perception that these and other changes might trigger renewed protectionism has led to some concern. However, this trend appears to be confined to a relatively small number of countries, and to specific industries. In 2006, 147 policy changes making host-country environments more favourable to FDI were observed. They included, in particular, measures aimed at lowering corporate income taxes and expanding promotional efforts. Further liberalization of specific industries is under way in various countries, such as that relating to professional services, telecommunications, banking and energy. In some industries, however, new restrictions on foreign ownership or measures to secure a greater government share in revenues were observed. Such steps were the most common in extractive industries and in industries deemed to be of “strategic” importance.

High mineral prices have brought natural resources back in focus

Recent years have seen a revival of FDI in extractive industries, reflecting the commodity price boom. This represents a window of opportunity for mineral-rich countries to accelerate their development. This is especially important as we reach the midpoint in our efforts to reach the Millennium Development Goals. The boom has reminded all countries of the importance of secure supply of natural resources. No modern economy can function without adequate, affordable and secure access to these raw materials.

Booming African markets: FDI and the common man

Lusaka Stock Exchange added $1.1 billion in the first 7 months of 2007, - 3-folds FDI inflows for Zambia in 2006 and Africa’s best performer (in US$) for the period. A clear FDI-Stock market policy may be needed to grow the markets and broaden participation. (Source: Brian Tembo, LuSE)



Global mineral markets are characterized by an uneven geographical distribution of reserves, production and consumption. These imbalances sometimes create concerns among importing countries over the security of supply, and concerns among exporting countries over market access. TNCs are important for both groups of countries. Mineral-rich developing countries that lack the domestic capital and expertise to exploit their natural resources often rely on TNCs to supply the necessary inputs. This is particularly the case for metal mining and for relatively remote or inaccessible oil and gas fields. Meanwhile, developing countries whose demand for mineral resources is fast expanding are increasingly encouraging their State-owned companies to invest abroad to secure long-term, stable access to such resources.

Although extractive industries make up only 9% of the global stock of FDI, in all the major country groups, they account for a significant share of the total inward FDI stock in some countries. This applies, for example, to Australia, Canada and Norway among developed countries; Botswana, Nigeria and South Africa in Africa; Bolivia, Chile, Ecuador and Venezuela in Latin America and the Caribbean; and Kazakhstan in South-East Europe and the CIS. In a number of low-income, mineral-rich countries, extractive industries account for the bulk of inward FDI; many have few other industries that can attract significant FDI, due to their small domestic markets and weak production capabilities.

Investments in the extractive industries are spanning the globe. In *metal mining*, 15 of the 25 leading companies in 2005, ranked by their share in the value of world production, were headquartered in developed countries. Eight others were from developing countries and the two remaining were from the Russian Federation. The top three were BHP Billiton (Australia), Rio Tinto (United Kingdom) and CVRD (Brazil). The relative importance of foreign companies in the production of metallic minerals and diamonds varies considerably. Foreign affiliates account for virtually all of the (non-artisanal) production in LDCs such as Guinea, Mali, the United Republic of Tanzania and Zambia, as well as in Argentina, Botswana, Gabon, Ghana, Mongolia, Namibia and Papua New Guinea. In these countries, TNCs generally operate through concessions granted in the form of exploration and mining licences. By contrast, in the Islamic Republic of Iran, Poland and the Russian Federation their share is negligible.

In *oil and gas*, world production is no longer dominated by developed-country TNCs, as was the case in the early 1970s when the so-called "Seven Sisters" reigned. Today, State-owned companies from developing and transition economies are the biggest producers. In fact, the world's top three oil and gas companies all belong to this category: Saudi Aramco, Gazprom and the National Iranian Oil Company. In recent years, a number of State-owned oil and gas companies from the South have made significant inroads into foreign locations. Foreign affiliates generally account for a lower share of production than in metal mining. In 2005, they were responsible for an estimated 22% of global oil and gas production, with the average share being higher in developed countries (36%) than in developing countries (19%) and transition economies (11%). However, there was wide variation among developing countries. Foreign companies accounted for more than half of production in Angola, Argentina, Equatorial Guinea, Indonesia, Sudan and the United Kingdom. On the other hand, no production was attributed to foreign affiliates in, for instance, Kuwait, Mexico and Saudi Arabia.

Development and policy implications

Mineral endowments provide opportunities for economic development and poverty alleviation in the countries where they are located. Too often, however, the impact of extractive activities has been and remains disappointing. The well-known costs and benefits of FDI extend equally to the extractive industries. In fact, more than in other industries, the impacts of resource extraction are not just economic, but encompass the environmental, social and political dimensions as well. The net development outcome depends on the quality of governance, specific policies and institutions in the host countries, the nature of minerals extracted, the domestic capabilities of the host country, and the behaviour of the TNCs.

From an economic perspective, TNCs can contribute capital, technology, management expertise and access to markets. Such inputs are particularly important in countries with weak domestic capabilities and for technologically complex projects. They can help expand production and exports, improve productivity and generate government revenues. But TNC involvement comes at a price. Foreign investors claim a significant share of the revenue generated, and repatriate what is often a large part of the profits. The potentially most important contribution from TNC participation may be a rise in host-country income, including government revenue.

In both the oil and gas and the metal mining industries, the evolving arrangements reflect an ongoing process through which governments seek to find an appropriate balance between the respective rights and obligations of States and firms. As government revenue is among the

Table 1. The world's 10 largest metal mining and oil and gas companies, ranked by total production, 2005

Rank 2005	Company name	Home country	State ownership (%)	Share in world production (%)	Number of host economies with production
Metal mining					
1	BHP Billiton	Australia	-	4.8	7
3	Rio Tinto	United Kingdom	-	4.6	10
2	CVRD	Brazil	12	4.4	-
4	Anglo American	United Kingdom	-	4.3	9
5	Codelco	Chile	100	3.2	-
6	Norilsk Nickel	Russian Federation	-	2.2	1
7	Phelps Dodge	United States	-	2.0	2
8	Grupo México	Mexico	-	1.6	2
9	Newmont Mining	United States	-	1.3	7
10	Freeport McMoran	United States	-	1.3	1
Oil and gas					
1	Saudi Aramco	Saudi Arabia	100	8.8	-
2	Gazprom	Russian Federation	51	7.7	2
3	NIOC	Iran, Islamic Rep.	100	3.9	
4	ExxonMobil	United States	-	3.7	23
5	Pemex	Mexico	100	3.5	
6	BP	United Kingdom	-	3.3	19
7	Royal Dutch Shell	United Kingdom / Netherlands	-	3.2	25
8	CNPC	China	100	2.4	14
9	Total	France	-	2.1	27
10	Sonatrach	Algeria	100	1.9	1

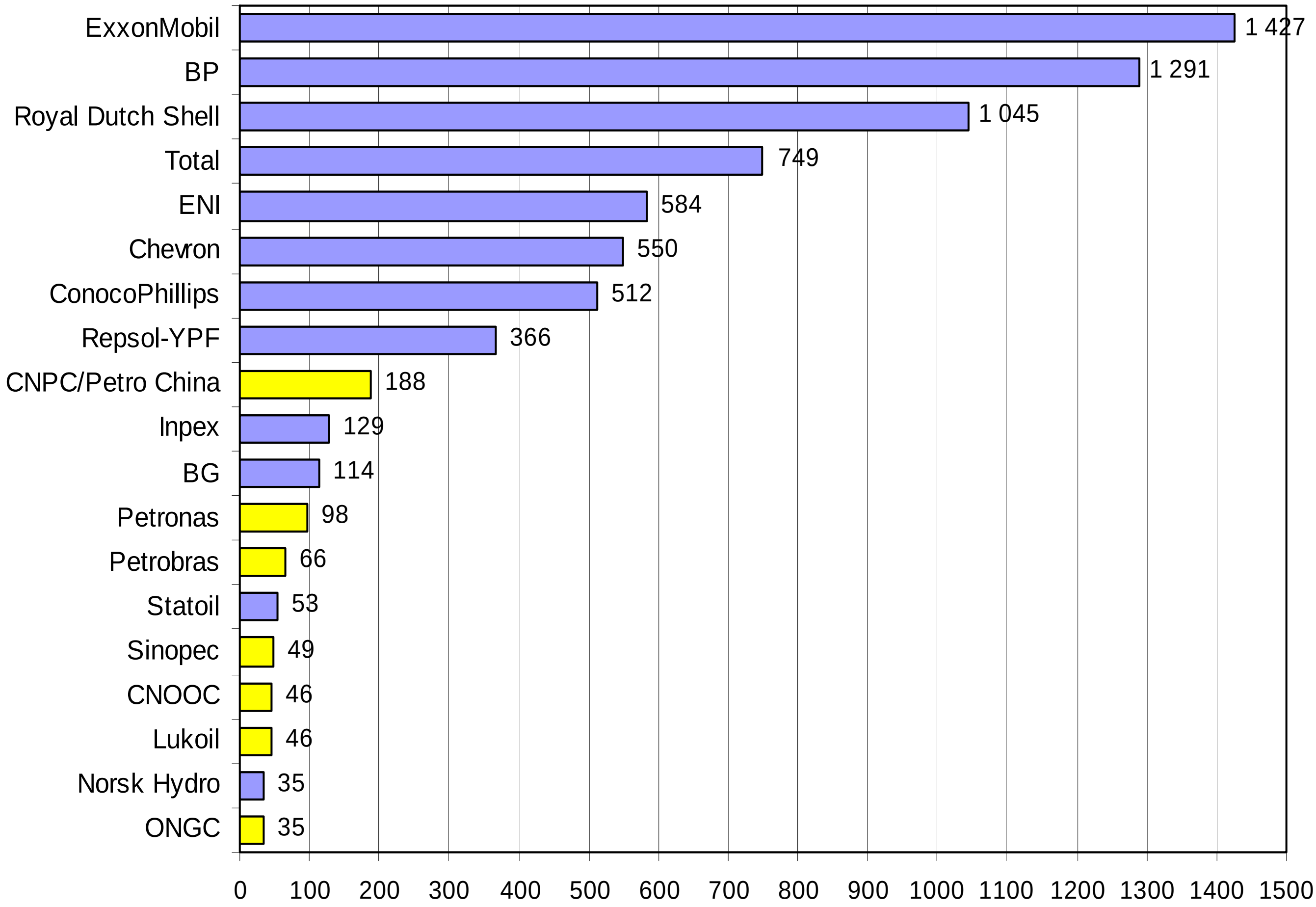
Source: UNCTAD, based on data from the Raw Materials Group and IHS.

most important benefits from mineral extraction, it is not surprising that policymakers devote much attention to finding a mechanism that assures the government an appropriate share in the profits from mineral extraction. As the result of higher mineral prices in the past few years, a number of governments have taken steps to increase their share of the profits generated by amending their fiscal regimes or their contractual relations. Recent regulatory changes in developed, developing as well as transition economies suggest that many governments believed their previous regulations may have been overly generous vis-à-vis foreign investors.

In order to reap not just more revenues, but more development gains as well, government revenue from natural resources has to be managed and used so as to promote development objectives. In this context, it is important to enhance revenue transparency. Available information on the sharing and distribution of revenue is patchy at best. One major way to address this is for more TNCs, host countries and home countries to commit to the principles of the Extractive Industry Transparency Initiative (EITI).

Managing the considerable environmental, social and political risks associated with extraction projects, and promoting sustainable development, will require that many countries improve their institutions and policies. Securing long-terms gains from such projects, especially when TNCs participate, must involve a concerted effort not only by host-country governments, but from the TNCs and their home countries as well. Home countries should promote the responsible behaviour of their TNCs, especially when they own the investing companies. Home countries can also help recipient countries build efficient policy and governance. The role of TNCs, in turn, is to contribute to more efficient production while respecting the laws of the host country. When the extraction takes place in a weakly governed or authoritarian State, companies need to carefully consider the

Figure 2. Oil and gas production of selected TNCs outside their home country, 2005(Millions of barrels of oil equivalent)



Source: UNCTAD, based on data from the Raw Materials Group and IHS.

implications of such investments, and if they do invest, need to abide by internationally acceptable standards.

Voluntary initiatives can be a useful supplement in countries where appropriate legislation or its enforcement is absent. A number of multi-stakeholder initiatives have been established with the aim of reducing the risk of conflict-related resource extraction and setting standards for corporate behaviour in conflict situations. The most notable ones include the EITI, the Kimberley Process Certification Scheme, the Voluntary Principles on Security and Human Rights and the Global Reporting Initiative. However, it is important for more countries and TNCs in extractive industries to become involved in these initiatives. Their impact will depend on universal compliance.

The challenge is to develop frameworks that create proper incentives for local and foreign firms to produce efficiently, while at the same time respecting environmental and social requirements that reflect the interests of local communities and society at large. The current commodity price boom represents a window of opportunity for developing economies to use their mineral resources to promote sustainable development. And particularly for the least developed countries endowed with natural resources, the boom should help them meet the Millennium Development Goals. In this endeavour, all countries and companies concerned have a role to play.

About the Paper

The article is based on the World Investment Report 2007 by UNCTAD accessible at www.unctad.org/wir